



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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IN REPLY REFER TO

PAC 730.31/2002-14

August 28, 2002  
02-PAC-064(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA**  
**DIRECTOR, FIELD DETACHMENT, DCAA**

**SUBJECT:** Supplemental Audit Guidance on Changes to FAR 31.205-35,  
Relocation Costs

MRD 02-PAC-059, issued August 13, 2002, discussed changes to FAR 31.205-35, Relocation costs, effective on contracts awarded on or after July 29, 2002. One of the significant changes was to make allowable payments to employees for increased employee income or Federal Insurance Contributions Act taxes related to relocation expenses (commonly referred to as "tax gross-ups"). This MRD provides guidance on the proper calculation of such payments to employees.

A common method for calculating the tax gross-up is:

$$\text{Tax Gross-Up Factor} = \frac{x}{1.0 - x} \quad (\text{where, } x = \text{employee's marginal tax rate})$$

For example, assume that the employee's marginal tax rate is 28% and the non-deductible moving expenses are \$50,000. A company would commonly compute the tax gross-up amount as follows:

$$\text{Tax gross-up factor} = 0.28 / (1.0 - 0.28) = 0.3888888$$

$$\text{Tax gross-up amount} = \$50,000 \times 0.3888888 = \$19,444.44$$

Simply increasing the employee's \$50,000 payment by the 28% marginal tax rate (i.e., \$14,000) will not make the employee whole. This is because the employee must then also pay taxes on the additional \$14,000. The tax gross-up amount must be sufficient to pay not only the additional tax on the taxable relocation expenses, but the taxes on all amounts paid to the employee to reimburse the additional employee taxes. The formula shown above reaches that result. In essence, the formula summarizes the following computations:

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		<b>Tax Paid</b>
Tax on	\$50,000.00	\$14,000.00
Tax on	\$14,000.00	\$3,920.00
Tax on	\$3,920.00	\$1,097.60
Tax on	\$1,097.60	\$307.33
Tax on	\$307.33	\$86.05
Tax on	\$86.05	\$24.09
Tax on	\$24.09	\$6.75
Tax on	\$6.75	\$1.89
Tax on	\$1.89	\$0.53
Tax on	\$0.53	\$0.15
Tax on	\$0.15	\$0.04
Tax on	\$0.04	\$0.01
Total Tax		<u><u>\$19,444.44</u></u>

If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact Karen Cash, Program Manager, Accounting and Cost Principles Division, at (703) 767-3250 or Karen.cash@dcaa.mil.

/s/ Robert DiMucci  
/for/ Lawrence P. Uhlfelder  
Assistant Director  
Policy and Plans

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